

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:

Telephone Number:

Refer Reply To:
CC:INTL:B05
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August 01, 2016

Legend

A =
CFC 1 =
CFC 2 =
Country A =
Parent =
US Sub =
Corp A =
Corp B =
X % =
Y% =
Z% =
Regulator =
Day X =

Dear :

In a letter dated A, you requested a ruling allowing CFC 1 and CFC 2 (collectively, the "CFCs") to use certain foreign statement insurance reserves in computing foreign personal holding company income under section 954 on the grounds that these insurance reserves are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii). Specifically, you requested permission to use (1) the underwriting reserves, loss reserves, and policyholders' dividend reserves for life insurance and annuity contracts reported by CFCs on their Country A Annual Report; and (2) the underwriting reserves, loss reserves, and associated asset bases

attributable to CFCs' separate account-type contracts, as reported on the Country A Annual Report.

The rulings given in this letter are based on facts and representations submitted by Parent and accompanied by a statement executed under penalty of perjury by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

Facts

Parent is a publicly-traded domestic corporation that is engaged, through its subsidiaries, in various lines of business, which primarily include life insurance, accident and health insurance, credit insurance, annuities, endowment and retirement and savings products. Parent directly and indirectly owns all the stock of US Sub. US Sub owns all the stock of Corp A. Corp A owns all the stock of Corp B. Corp B owns approximately X% of CFC 1. US Sub owns approximately Y% of CFC 1. Corp B also owns approximately Z% of CFC 2. Parent represents that CFCs are controlled foreign corporations as defined in section 957. CFCs are both engaged in the life insurance business in Country A. CFC 1's principal products are traditional life (both term insurance and permanent insurance), variable whole life that employ separate account funds, variable universal whole life, fixed annuities, and retirement insurance for both companies and individuals. CFC 2's principal products are individual and group voluntary annuities and pension annuities.

Country A regulates any insurance business conducted in Country A through its insurance laws and regulations. Regulator developed and is responsible for enforcing insurance laws and regulations in Country A. An insurance company must obtain a license from the Regulator to conduct an insurance business in Country A.

CFCs are licensed by the Regulator to sell life insurance and annuity contracts to persons in Country A and are subject to regulation by Regulator as life insurance companies. CFCs do not carry on business other than life insurance and certain activities that are incidental to the life insurance business. Each of the CFCs derives greater than 50 percent of its aggregate net written premiums from the issuance of life insurance and annuity contracts covering applicable home country risks. No policyholder, insured, annuitant, or beneficiary to a life insurance or annuity contract that the CFCs issue is a related person as defined in section 954(d)(3). Parent has represented that CFCs would be subject to tax under Subchapter L if they were domestic corporations.

The CFCs also issue separate account-type variable life insurance and annuity contracts, which are separately identified and maintained, and are supported by separately identifiable pools of assets. The assets in the pools are marked to market for local regulatory reporting purposes and the associated reserve follows movements in

the value of the assets (with very limited exceptions, such as surrender charges). For Country A tax and insurance regulatory purposes, the CFCs are required to make asset basis and reserve-related adjustments to its separate accounts (including premiums received but not yet allocated to the separate accounts).

As required by Country A's insurance laws and regulations, CFCs file Annual Reports and financial statements with the Regulator. The Annual Reports are audited by an external accounting firm in addition to the companies' internal auditor. The accounting records of CFCs that form the basis for preparing the Annual Reports are subject to inspection by the Regulator at any time. The Annual Reports are made available to the public. In addition to their use for regulatory purposes, the Annual Reports are used for financial purposes, such as Country A credit rating, by lenders, and the public. Day X is the official year end for life insurance companies operating in Country A.

To comply with Country A's insurance laws, CFCs must establish and maintain reserves for their obligations to holders of their life insurance and annuity contracts and must report the amount of such reserves on the Country A Annual Report. The reserves at issue in the ruling request are limited to the underwriting reserves, loss reserves, and policyholders' dividend reserves that the CFCs maintain on their Country A Annual Reports for life insurance or annuity contracts.

CFCs have appointed a qualified actuary to be involved in matters designated by the Regulator as actuarial matters, including the method of calculating reserves. The actuary has knowledge and experience concerning actuarial matters for a company in Country A engaged in the insurance business.

The reserve system for Country A includes the following requirements as to assumptions and method with respect to life insurance and annuity contracts issued by CFC 1. Underwriting reserves are required to secure the performance of future obligations arising from life insurance contracts. CFC 1's underwriting reserves are comprised of insurance premium mathematical reserves and unearned premium reserves. Generally, the reserve methods and mortality and interest assumptions are submitted to the Regulator by a qualified actuary and subject to approval by the Regulator. CFC 1 currently holds traditional life insurance reserves determined using the net level premium method, universal life reserves using full account values, and other fund-based reserves, also using full account value. CFC 1 also holds loss reserves for outstanding claims (including claims that have been incurred but not reported) under life insurance issued by CFC 1 and calculates the reserves using the company's individual accrued liability experience and estimates of liabilities for claims incurred but not reported. The policyholders' dividend reserves represent portfolio profit-sharing components of the policies as of the statement date for profit sharing to be credited at the next contract anniversary.

The reserve system for Country A includes the following requirements as to assumptions and method with respect to life insurance and annuity contracts issued by

CFC 2. Underwriting reserves are comprised of annuity account values during the deferred annuity accumulation periods and annuity mathematical reserves for annuities in the payout period. Generally, the reserve methods and mortality and interest assumptions are submitted to the Regulator by a qualified actuary and subject to Regulator approval. CFC 2 also holds loss reserves for outstanding benefit payments under annuity contracts issued by CFC 2 and calculates the reserves using the company's individual accrued liability experience. In the case of a contract that is treated as participating in the profit of a line-of-business portfolio, an amount of policyholders' dividend reserves would be held on the balance sheet for this provision.

Parent represents that: (1) CFCs are not engaged in any insurance business outside of Country A and do not carry on any non-life insurance business; and (2) each contract covered by the rulings requested is a life insurance contract or annuity contract for federal income tax purposes, without regard to sections 72(s), 101(f), 817(h) and 7702.

The reserves covered by this ruling do not include: (1) deficiency reserves; (2) contingency reserves; (3) equalization reserves; (4) excess interest reserves for excess interest credited beyond the end of the taxable year; (5) reserves for administrative expenses (including guarantees intended to cover future expenses associated with the payment of claims such as bank fees or inflation risk); (6) underwriting or loss reserves for non-cancellable and guaranteed renewable accident and health contracts; (7) reserves for any amount to protect against a future decline in the value of investment assets; or (8) any reserves for accrued liabilities.

Law

In general, a United States shareholder of a controlled foreign corporation ("CFC") must include in gross income its pro rata share of the CFC's Subpart F income for each year. Subpart F income includes, among other types of income, insurance income under section 953 and foreign base company income under section 954.

Section 953(a)(1) defines the term "insurance income" to include any income that is attributable to the issuing or reinsuring of an insurance or annuity contract, and that would be taxed under Subchapter L if such income were the income of a domestic insurance company. Section 953(a)(2) provides that section 953 insurance income does not include "exempt insurance income" derived by a "qualifying insurance company." Section 953(b)(3) provides that reserves for any insurance or annuity contract shall be determined in the same manner as under section 954(i).

Section 953(e)(1) defines "exempt insurance income" as income derived by a qualifying insurance company that is attributable to the issuing (or reinsuring) of an "exempt contract" by such company and that is treated as earned by such company in its home country for purposes of such country's tax laws. "Exempt contracts" are defined under section 953(e)(2) to include insurance or annuity contracts issued by a qualifying

insurance company in connection with the lives or health of residents of a country other than the United States, but only if such company derives more than 30 percent of its net written premiums from otherwise exempt contracts which cover applicable home country risks and with respect to which no policyholder, insured, annuitant or beneficiary is a related person within the meaning of section 954(d)(3).

In general, section 953(e)(3) defines a “qualifying insurance company” as any CFC that:

(A) is subject to regulation as an insurance company by its home country, and is licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance or annuity contracts to persons other than related persons (within the meaning of section 954(d)(3)) in such home country;

(B) derives more than 50 percent of its aggregate net written premiums from the issuance by such controlled foreign corporation of contracts covering applicable home country risks of such corporation and with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in section 954(d)(3)); and

(C) is engaged in the insurance business and would be subject to tax under Subchapter L if it were a domestic corporation.

Section 954(a)(1) defines the term “foreign base company income” to include, among other types of income, “foreign personal holding company income.” Section 954(c)(1) sets forth the types of income that are considered foreign personal holding company income. Section 954(i)(1) provides that for purposes of section 954(c)(1), foreign personal holding company income does not include “qualified insurance income” of a “qualifying insurance company.”

Section 954(i)(2) defines the term “qualified insurance income” to mean income of a qualifying insurance company falling into two categories. The first category is income received from unrelated persons and derived from investments made by a qualifying insurance company or qualifying insurance company branch (collectively referred to as a “QIC”) either of its reserves allocable to exempt contracts or of 80 percent of its unearned premiums from exempt contracts (as both are determined in accordance with section 954(i)(4)). The second category is income received from unrelated persons and derived from investments made by a QIC of an amount of its assets allocable to exempt contracts equal to: (1) in the case of property, casualty, or health insurance contracts, one-third of the premiums earned on those contracts during such year; and (2) in the case of life insurance or annuity contracts, 10 percent of the reserves described in section 954(i)(2)(A) for such contracts.

Section 817 generally provides special rules for certain variable contracts for purposes of Part I of Subchapter L of the Code. Section 817(d) defines a “variable contract” as any contract that (1) provides for the allocation of all or part of the amounts received under the contract to an account which, pursuant to state law, is segregated from the general asset accounts of the company, and (2) either provides for the payment of annuities, is a life insurance contract, or provides funding for insurance on retired lives.

If a contract satisfies the variable contract requirements, and the separate account that funds the variable contract is treated as a segregated asset account, section 817 requires that certain adjustments be made to the insurance company's asset basis and insurance tax reserves with respect to the segregated asset account. Section 817(a) provides that, with respect to any variable contract, reserves are adjusted (1) by subtracting an amount equal to the sum of the amounts added from time to time (for the taxable year) to the reserves separately accounted for by reason of appreciation in value of assets (whether or not the assets have been disposed of) and (2) by adding thereto an amount equal to the sum of the amounts subtracted from time to time (for the taxable year) from such reserves by reason of depreciation in value of assets.

Under section 817(b), the basis of each asset in a segregated asset account is increased or decreased by the amount of appreciation or depreciation, respectively, to the extent the reserves or other items referred to in section 817(a) are adjusted. The asset basis and insurance tax reserve adjustments offset any realized gain/loss attributable to such marked assets at the insurance company level.

Section 954(i)(3) imposes separate contract treatment for "separate account-type contracts," a term which includes contracts not meeting the requirements of section 817. Section 954(i)(3)(A) provides that, for purposes of applying section 954(i) and with respect to any separate account-type contract (including any variable contract not meeting the requirements of section 817), income credited under such contract is allocable only to such contract. Income not allocable to a separate account-type contract is allocated ratably among contracts.

Section 954(i)(4)(B)(i) generally provides that in the case of life insurance and annuity contracts, a QIC's reserves allocable to exempt contracts are equal to the greater of (1) the net surrender value of the contract or (2) the reserve determined under section 954(i)(5). Section 954(i)(4)(B)(ii), however, provides:

The amount of the reserves under section 954(i)(4)(B)(i) shall be the foreign statement reserve for the contract (less any catastrophe, deficiency, equalization, or similar reserves), if, pursuant to a ruling request submitted by the taxpayer or as provided in published guidance, the Secretary determines that the factors taken into account in determining the foreign statement reserve provide an appropriate means of measuring income.

Section 954(i)(4)(B)(ii) was originally enacted by section 614 of the Job Creation and Worker Assistance Act of 2002. Under the Protecting Americans from Tax Hikes (PATH) Act of 2015 (P.L. 114-113, 12/18/2015), section 954(i) was permanently extended and made effective for taxable years of foreign corporations beginning after December 31, 2014, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end. In its Technical Explanation to the

PATH Act, the staff of the Joint Committee on Taxation explains section 954(i)(4)(B)(ii) as follows:

The provision does, however, permit a taxpayer in certain circumstances, subject to approval by the IRS through the ruling process or in published guidance, to establish that the reserve for such contracts is the amount taken into account in determining the foreign statement reserve for the contract (reduced by catastrophe, equalization, or deficiency reserve or any similar reserve). IRS approval is to be based on whether the method, the interest rate, the mortality and morbidity assumptions, and any other factors taken into account in determining foreign statement reserves (taken together or separately) provide an appropriate means of measuring income for Federal income tax purposes.

Joint Comm. on Taxation, Technical Explanation of the Revenue Provisions of the Protecting Americans from Tax Hikes Act of 2015, House Amendment #2 to the Senate Amendment to H.R. 2029 (Rules Committee Print 114-40) (JCX-144-15 (December 17, 2015)).

Analysis

CFC 1 and CFC 2 are subject to regulation as life insurance companies by Country A. CFC 1 and CFC 2 are licensed, authorized, and regulated by the Regulator, which is the insurance regulatory body for Country A, to sell life insurance and annuity contracts to persons other than related persons (within the meaning of section 954(d)(3)) in Country A. Parent has represented that CFC 1 and CFC 2 each derive more than 50 percent of their aggregate net written premiums from the issuance of life insurance and annuity contracts covering applicable home country risks and with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in section 954(d)(3)). Finally, Parent has represented that CFC 1 and CFC 2 are engaged in the life insurance business and would be subject to tax under Subchapter L if they were domestic corporations. Accordingly, CFC 1 and CFC 2 are QICs under section 953(e)(3).

CFC 1 and CFC 2 issue life insurance and annuity contracts in connection with the lives and health of residents of Country A, a country other than the United States. CFC 1 and CFC 2 derive more than 30 percent of their net written premiums from contracts that cover Country A risks with respect to which no policyholder, insured, annuitant, or beneficiary is a related person within the meaning of section 954(d)(3). Such contracts are, therefore, exempt contracts within the meaning of section 953(e)(2).

CFC 1 and CFC 2 must establish, maintain, and calculate their underwriting reserves and loss reserves in accordance with the insurance laws and regulations prescribed by the Regulator. The Regulator requires a life insurance company to determine the amount of its underwriting reserves based on guidance provided by the Regulator. CFC 1 and CFC 2 must set forth their underwriting reserves and loss reserves on the

Country A Annual Report, which must be filed annually with the Regulator. These reserves are the measure of the legal obligations to policyholders on the financial statement used for regulatory purposes by life insurance companies doing business in Country A (whether U.S.-owned, locally-owned, or owned by companies headquartered in other foreign countries). The Regulator requires CFC 1 and CFC 2 to hold reserves for the fulfillment of claims owed to policyholders and beneficiaries. The reserves are not catastrophe, deficiency, equalization, or similar reserves. Under the rules prescribed by the Regulator for determining reserves required to be calculated for purposes of the Country A Annual Report, the method, interest rate, the mortality and morbidity assumptions and other factors taken into account provide an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii).

For Country A insurance regulatory purposes, CFC 1 and CFC 2 are each required (1) to mark to market its portfolio investment assets held pursuant to its separate account-type contracts, (2) to adjust the bases of its marked portfolio investment assets to fair market value, and (3) to adjust its underwriting reserves and loss reserves in order to offset any realized gain or loss attributable to the marked assets. The asset basis and reserve-related adjustments prevent CFC 1 and CFC 2 from reporting distortions in the amount and timing of its income on its Country A Annual Report to the Regulator. This method clearly reflects income as does the rules provided by section 817 for domestic insurance companies taxed under subchapter L. Under the rules prescribed by the Regulator for determining reserves required to be calculated for purposes of the Country A Annual Report, the method, interest rate, the mortality and morbidity assumptions and other factors taken into account provide an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii).

Ruling

Based on the information submitted and the representations made, we rule as follows:

(1) Under the facts set forth above, the foreign statement underwriting reserves, loss reserves, and policyholders' dividend reserves maintained by CFC 1 and CFC 2 with respect to their exempt life insurance or annuity contracts are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii) and may be used in determining the foreign personal holding company income of CFC 1 and CFC 2 under section 954(i).

(2) Under the facts set forth above, the foreign statement underwriting reserves, loss reserves, and associated asset bases attributable to CFC 1's and CFC 2's separate account-type contracts are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii) and may be used in determining the foreign personal holding company income of CFC 1 and CFC 2 under section 954(i).

Caveats

We express no opinion on any provisions of the Code or regulations not specifically covered by the above ruling. This ruling will be subject to revocation if any of the following circumstances occurs: (1) a change in the material facts on which this ruling was based; (2) a material change in the business circumstances of CFC 1 or CFC 2 which would impact its reserving method; or (3) a change in the applicable law or foreign rules relating to the current reserving method of CFC 1 or CFC 2.

Procedural Statements

This ruling is directed only to CFC 1 and CFC 2. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Mark E. Erwin
Branch Chief, Branch 5
Office of Associate Chief Counsel (International)

cc: